REDUCTION IN U.S. EXPORT CONTROLS

OBJECTIVE

The lifting of the retroactive features of U.S. controls on exports to the USSR and to Poland if we achieve satisfactory agreement with our Allies to (a) join our embargo of future transfers of key categories of oil and gas equipment and technology, (b) restrain export credits to the Soviets, (c) reaffirm and expand the commitment to improve COCOM, and (d) seek non-Soviet energy sources.

ANALYSIS

The feature of our sanctions that the Europeans find most objectionable is their retroactive effect. In Margaret Thatcher's words, "once you have got a deal, you have to keep it, short of war..." The President has authorized the elimination of this feature if we are able to achieve satisfaction on our objectives.

Assuming success, we would then have to make appropriate changes in order to eliminate their impact on contracts entered into with the Soviets prior to December 30, 1981. This will require several modifications in the sanctions, as well as in the denial orders. These details, however, need not be addressed in the meeting with the Europeans.

If sufficient progress is made in achieving essential agreement at our first meeting, we might consider suspending the denial orders in advance of working out all the details of a final package of agreements.

Cost to U.S. of Sanctions

The Europeans maintain that the United States is being unreasonable in asking them to sacrifice pipeline-related exports while the United States proceeds with grain exports. However, various U.S. Government foreign policy restrictions on trade with the USSR imposed since 1974 have caused substantial sacrifices in U.S. exports to the USSR of both agricultural and industrial items.

1) Jackson-Vanik Amendment - The Trade Act of 1974 (enacted in 1975) conditioned government-supported export credits and most-favored-nation tariff treatment for the USSR (and for other non-market economies) on satisfactory emigration performance. The USSR responded by refusing to ratify a 1972 US-USSR trade agreement. Soviet leaders stated that the U.S. action caused them to divert from U.S. to non-U.S. suppliers purchases valued at $2 billion. We cannot document which contracts were so diverted. One possible example is a Sperry Rand air traffic control (ATC) system. Some Soviet officials maintained that the Datasaab Swedish competition was chosen because of lower price but other Soviet officials told Americans that selection of the Swedish ATC system was politically motivated.

2) Reaction to dissident trial and harassment of Americans - In 1978 the United States denied a Sperry computer to TASS and imposed controls on oil and gas exploration and production equipment in response to the Shcharansky trial and the arrest and harassment of U.S. businessmen and journalists. A French company, CII, thereupon sold a replacement computer to TASS and a French company, Technip, concluded a contract for gaslift equipment, valued at about $200 million, which the American bidder, Teledyne, maintained would have gone to it had it not had to wait for a U.S. license.

3) Afghanistan sanctions - In 1980, in response to the Soviet invasion of Afghanistan, the United States imposed embargoes on grain and on phosphate fertilizers and tightened controls on industrial goods.

a) Grain - Sales in the 1979/80 year were expected to be about 25 million tons. Actual sales were limited to 8 million tons, a loss of 17 million tons (c.$ billion). Other suppliers replaced much of this at the time. Before the embargo we expected to sell soybean meal to the USSR. Since the embargo the Soviets have bought soybean meal exclusively from non-U.S. suppliers. (c.$ million per year).

b) Phosphates - The phosphate embargo, which was in effect from May 1980 to April 1981, suspended shipments of super phosphoric acid (SPA) under a 20-year $20 billion Occidental Petroleum deal. While the U.S. embargo was in effect, the USSR contracted on a long-term basis to replace approximately half of the SPA which was to have been supplied by the United States, specifically:

i) a 20-year contract with Belgium for 160,000 metric tons of SPA;

ii) a 5-year contract with Morocco for 200,000 metric tons of merchant grade acid (a form of phosphoric acid) for the first two years and 300,000 tons of SPA thereafter; and

iii) a 3-year contract with Tunisia for 230,000 metric tons of merchant grade acid.

c) Industrial goods - From January through March 1980 the U.S. suspended the validity of previously issued export licenses and the issuance of any new licenses. Thereafter, the United States instituted a policy of no-exceptions to the USSR for items requiring COCOM review and administered that policy more restrictively than did other COCOM members, e.g., by not approving parts to service previously exported equipment, by denying large cases with minor COCOM-controlled components rather than approving such cases if the COCOM-controlled components were removed, and by reviewing cases for Eastern Europe on a more rigorous basis than before. Specific results included the loss of the $90 million Armco Steel portion of an Armco. Nippon Steel contract for the construction of a steel mill (subsequently replaced by Creusot-Loire) and of the $80 million Alcoa portion of a contract for an aluminum smelter (subsequently replaced by the German firm, Kloeckner). In addition, U.S. computer manufacturers lost substantial markets in Eastern Europe to Siemens and other European companies. The effect of U.S. Afghanistan sanctions on new Soviet orders of U.S. machinery and equipment was dramatic: from July through December of 1980 the United States received only $0.5 million such orders, out of a total of new Western orders of $1,452.9 million for that period. This compared with the average six month total of new U.S. orders in 1978 and 1979 of $208 million, out of an average total of new Western orders of $1,360.5 million. (Six month averages in 1981-U.S. $148 million and total Western $3,416 million in complete data for seven months of 1982-U.S. $35 million and total Western $1,918 million.)

4) Poland sanctions - The December and June U.S. sanctions in response to the imposition of martial law in Poland have had a further deleterious effect on U.S. exports, both agricultural and non-agricultural.

a) Grain - In the wake of the embargo, the U.S. market share has dropped from 70 percent to 30 percent, with no expectation of regaining the lost ground. When negotiations on a new long-term grain agreement were postponed in December, the Soviets boycotted the U.S. grain market for two months. In response to the U.S. expansion of sanctions in June the Soviets boycotted the U.S. market once again. They have made no purchases since May. For the first time, there are no orders on the books for the next agreement year, which begins October 1.

b) Industrial goods - In December the U.S. suspended issuance of licenses for all items requiring a license for export to the USSR. This included not only items requiring COCOM review, but also items excluded from the 1980 U.S. proposal to COCOM for a no-exceptions policy, items approvable at national discretion under COCOM rules, and items controlled unilaterally by the United States (including not only oil and gas items but also all unpublished technical data related to any industrial process). The June sanctions expanded the U.S. controls to all oil and gas exploration, production, transmission, and refining for energy use, not just from the U.S. but also from subsidiaries and licensees. Examples of lost U.S. exports due to the December and June controls on U.S. trade include:

- $500 million Fiat-Allis technology and kits for crawler tractors;

- $175 million GE rotors.

- $100 million Cameron Iron Works blow-out preventers;

- $88 million Caterpillar pipelayers;

Also note that Soviet machinery orders for the first seven months of 1982 (based on incomplete data) were only $35 million from the United States, compared with $787 million from Germany, $190 million from Italy, $86 million from France, and $50 million from the United Kingdom.

Credits and Strategic Concerns

The availability of officially backed credits provides the Soviets with investment resources which they could not finance on their own or obtain from the West under normal commercial standards. This is particularly true for investments in capital goods, which marginally increase their ability to undertake projects to produce new goods, upgrade their quality levels, and avoid considerable research and development expenses by importing Western euqipment and technology at low rates of interest. This contribution to Soviet growth eases some resource constraints and allows a portion of their own investments to be directed into militarily significant industries instead of purely civilian channels.

However, imports backed by Western credits normally have only an indirect impact on the Soviet military build-up. If the Soviets want Western technology to meet a critical military need, they are willing to pay cash for it.

Overall, the USSR must finance with credit its current account balance of payment deficits. This is largely a function of massive grain purchases.

For items of military criticality, Western constraints should be in the form of export controls rather than credit controls. For machinery and equipment not sufficiently critical to warrant COCOM control, the credit issue is not substantially different from that which is relevant to items of no direct military significance, such as grain.

Nevertheless, occasionally Western credit has facilitated transfers of machinery and equipment of some military significance, either because strategic export controls were inadequate or because the military significance was too indirect to warrant imposition of export controls.

There are three broad areas of general industry in which the key role of Western imports is most evident as it pertains to defense industrial support; the machinery producing sector (including motor vehicles), the chemical industry (including tires and plastics) and the electronics industry (including computers and telecommunications). During the 1970s imports of Western products for these industries accounted for half of total hard currency imports. Of this amount, approximately a third was financed by government backed, low interest credits and loans. However, in a number of cases involving whole plant purchases or major projects, 80 percent financing was provided by the West. These major facilities account for a disproportionate share of the high technology transferred from the West.

Although the machinery, chemical and electronics sectors are not formally subordinate to the Ministry of Defense, they have extremely close supplier relationships to the final defense producing Ministries shown in enclosure 1. In many cases ostensibly civilian plants have closed areas in which either defense research is conducted or in which military end items are actually produced.

Machinery and Equipment:

In 1980, the Soviets imported $6 billion of Western machinery and equipment, accounting for 23 percent of their trade with the West and one-third of all such Soviet end-use imports. Some of the remaining machinery imports, primarily from East Europe, are also from Western sources. This volume of imports is equivalent to roughly 10 percent of the machinery component of capital investment in the entire economy. We are thus subsidizing 3% of Soviet investments in this area.

While the imported machinery was supplied to all sectors of the economy, particular emphasis was placed on those areas most directly supporting the military effort. Western financing, often at concessionary rates, enabled the Soviets to obtain advanced technology at exceptionally low costs.

- Most of the NATO countries supplied equipment for the Kama Truck Plant during the mid-1970s. This plant produces heavy trucks for both military and civilian use. Kamas trucks are in use by Soviet troops in both Afghanistan and Eastern Europe.

- In 1977, the FRG provided concessionary 7.5 percent financing for the export of jet turbine shafts to the USSR. The Soviet aircraft industry is almost totally integrated into the military production system.

- In August 1981, Japan granted the Soviets a credit related to an order for 12-ton trailer trucks. The size and specifications of these trucks make them easily convertible to missile and artillery transporters.

Chemicals:

Soviet truck tire production is markedly inferior compared to the West, with an average life one-eighth as long as comparable U.S. truck tires. Truck production has been the major priority in Soviet automotive production. Their potential for dual civilian/military use as well as the overall inadequacy of the Soviet road network are major factors for this emphasis. One out of five trucks in the USSR are estimated to be in military use; that is, 700,000 in a national inventory of about 4 million trucks.

- In May 1980, the French Government provided officially backed export credits to a French firm providing 80 percent financing on a tire factory to be constructed in the USSR. The total value of the credit was 11.8 million French francs.

- In September 1978, the West German Government provided an officially backed export credit for a facility to produce rubber mixtures in a tire factory at Tchimkent, USSR. Total value of contract: 207 million DM.

- A Japanese consortium has signed a $108.9 million contract with the Soviet foreign trade organization Techmashimport for the construction of two butadiene plants at the Tobolsk Petrochemical Complex in West Siberia. The Japanese are to provide machinery and engineering technology and to supervise the plant's construction and initial operations with financing to be handled by the Japanese Eximbank.

Electronics:

Soviet electronic engineers have stated that prior to Western imports there was no truly indigenious microelectronics industry because of the virtual lack of this technology in the USSR. Consequently, to close this gap, the USSR imported a full range of technology, whole plants, materials and equipment worth hundreds of millions of dollars and heavily financed by low interest credits. Soviet engineers also maintain that only one technological base exists in this industry which serves both civilian and military needs. They contend that the military obtains the highest quality, most reliable components that the industry as a whole can produce.

Conclusion:

The flow of legally exported Western technology, equipment and materials to the Soviet Union has been of considerable support to Soviet military programs. To the extent that Western governments have provided credits to underwrite this trade it has greatly facilitated the development and serial production of modern weapons. The Soviets are putting increasing emphasis on quality improvements in their weapons now that they have achieved quantity goals. The emphasis on quality will only heighten their need for Western products, particularly during a period of serious domestic economic stagnation. Since part of their economic dilemma is a severe shortage of hard currency the USSR will be in need of even more credit to sustain trade with the West.

Hard currency available for manufactured goods will have to be spent on continuing the purchase of spare parts and components needed to keep their large inventory of Western machinery producing. The impact of a reduction in the flow of legally exported Western industrial products probably would not be immediate. However, weapons being planned for the late 1980s or 1990s could experience many developmental and production problems if the Soviets are forced to use indigenous resources.

Enclosures:

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Coordinating Allied Controls on Exports to the USSR of Oil and Gas Equipment and Technology

Agreement on multilateral controls on such exports will require a multilateral mechanism to provide assurance that self-restraint by one supplier country would not be undermined by the competition in another.

The principal supplier countries are France, Germany, Italy, Japan, the United Kingdom, and the United States. Other occasional supplier countries are Canada, Netherlands, and Norway. All these countries are members of COCOM; all but Japan are members of NATO; all but Japan, the United States, and Canada are members of the EC.

If the supplying countries look for an organization to monitor the controls, the Europeans may initially think of acting together under the EC Treaty (the Treaty of Rome). They used the EC for controls on imports from Argentina and the USSR. (They adopted a limited ban on exports to Iran and a no-exceptions policy on exports to Poland of items requiring COCOM review by acting together informally outside the treaty.) But they may have second thoughts about using the EC for oil and gas equipment controls because of the following major disadvantages:

1) Enacting controls under article 113 of the Rome Treaty, which permits collective trade restraints without requiring subsequent national legislative action, would be resisted by EC member countries which are not supplier countries or which oppose use of this article for security-related measures, such as Greece, Ireland, and, perhaps, Denmark.

2) Basing controls on article 224 of the Treaty, which permits trade control measures for security purposes under national authority, would require that some EC members, such as the UK, enact authorizing national legislation.

3) Informal EC coordination outside the Treaty frame has the same drawback as using article 224.

4) EC coordination by itself would be inadequate because of the need for at least United States and Japanese, and perhaps also Canadian, participation in the process.

The Europeans may recall that NATO was used to coordinate the shortlived ban on pipe exports to the USSR in the 1960's. NATO was also used to coordinate contingency planning in 1981 for controls on exports to the USSR in the event of Soviet military intervention in Poland. However, there are major problems in bringing Japan into NATO deliberations. Moreover, use of NATO would not obviate the need for national legislation in the UK and perhaps elsewhere.

The Europeans may resist using COCOM because of their opposition to using COCOM for "economic warfare" or political purposes (the COCOM strategic criteria call for controlling items of Soviet deficiency with military significance in peacetime). On the other hand, if they had the political will to impose the controls we are suggesting, they might conclude that COCOM was the best route, for the following reasons:

1) COCOM is the only existing group which includes all the major supplier countries.

2) COCOM has 33 years' experience in coordinating the details of controls on exports to the USSR.

3) Other countries would not have to obtain new legislative authority to impose additional COCOM controls.

4) There are COCOM precedents for temporary controls, in the event that it was decided that the new controls should be removed if and when the three conditions for improvement in Poland in the NAC January 11 communique were fulfilled. These take the form of "validity" notes, whereby certain items are added to the list subject to the condition that they may be removed from the list at the initiative of any one member, provided notice is given before the expiration of a stated temporary period (usually a year or two).

5) Other COCOM members have sometimes agreed to add carefully defined items to the list, even if the justification therefor in terms of the COCOM strategic criteria was somewhat weak, if the United States was the major supplier (as would be the case historically for the items under consideration), especially if their future trade interests were protected by validity notes.

Large U.S. Projects Without Government Credit

The following U.S. contracts were concluded without benefit of government supported credits or credit guarantees:

	$ Million
1975 - Iron ore pelletizing	52
1975 - Friction bearing plant	47
1976 - Baby formula plant	25
1977 - Sub-sea oil equipment plant	30
1978 - Drill bit plant	148
1978 - TV color picture tube project	46
1979 - Steel mill (the Armco portion only; there were some Japanese credits to support the Nippon Steel portion)	90
? - Offshore oil rig	40
1972-1978 - Parts and accessories for track laying tractors for use in pipeline and railroad construction and in open pit mining	300
Total (excludes smaller value contracts)	778

(Also note the Commerce estimate that, from 1975 until the imposition of Afghanistan sanctions in early 1980, the United States lost at least $1 billion in exports as a result of withdrawal of access to official credits for sales of machinery and equipment to the Soviet Union. The U.S. share of industrialized Western country exports of machinery and transport equipment to the USSR fell from about 12% in the mid-1970's to about 7% in 1979.)

Increased Resources for National Enforcement of Export Controls and for the COCOM International Secretariat

Need for More Resources

Other COCOM member countries have very small staffs devoted to the national enforcement of export controls. Despite widespread evasions of controls (estimated on the order of $200 million over the past ten years), they investigate very few suspected violations and they prosecute almost no cases. The few investigations which do take place are usually a result of a presentation by the United States Government of intelligence suggesting the need for remedial action.

Other COCOM members (except the British and, occasionally, the French) seldom if ever involve their Defense Ministries in the review of COCOM control lists and cases, even though military significance is highly relevant to the COCOM strategic criteria.

Noting the paucity of resources, some exporters might conclude that their governments did not take the controls very seriously.

The efficiency of the COCOM secretariat would be increased by the acquisition of word processing equipment. The efficiency of the entire COCOM operation would be increased by the acquisition of a computer system to facilitate finding precedent cases. More dignified quarters for the secretariat and for the COCOM meetings would indicate to the participants a heightened sense of the importance and priority accorded to their work by the member governments.

Reasons Other Members Resist Devoting More Resources to COCOM

Budgetary problems are very real, especially during the current period of economic difficulties.

Even in more prosperous times, other members resist giving COCOM-related activities a high visibility. The governments recognize the importance of the operation, but they also are conscious of the following types of political problems which might arise from a higher profile:

- Since it is well known that the United States is by far the strongest advocate of controls, others are reluctant to give the impression that they are blindly following the U.S. lead and are not sufficiently mindful of their own national interests.

- Since it is well known that the USSR has reacted to U.S. controls by buying even uncontrolled items elsewhere, others want to protect their reputations of being reliable suppliers of such items.

- Since some other members have sizable and vocal minorities who are not sympathetic with the controls, even those who are convinced of the need for the controls are reluctant to publicize measures to enforce them.